

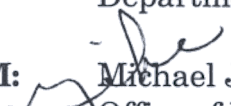


JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
OFFICE OF THE STATE BUDGET
LANSING

MARY LANNOYE
DIRECTOR

MEMORANDUM

TO: Department Internal Auditors
FROM:  Michael J. Moody, Director
Office of Financial Management

DATE: September 15, 2003

SUBJECT: Department Internal Audit Plans

This memorandum is being sent to establish required reporting of Internal Audit (IA) plans and to provide guidance on use of risk assessments as the basis for internal audit plans. At a minimum, the audit plan should list anticipated audit projects and resources (staff hours and/or financial resources) required, with planned IT audit coverage uniquely identified. In addition, the Internal Auditor may include:

- Descriptions of non-audit activities (including special projects and reviews) to be directed by the Internal Auditor.
- Classification of the nature of the audits (i.e. financial, both internal and external to State government operations; compliance; economy, efficiency, and performance).
- A description of the basis for determining audits within a defined overall audit universe.

International Standards for the Professional Practice of Internal Auditing (Standards) require that IA plans be based on a thorough risk assessment process. The assessment of risk is an analytical process departments can use to prioritize risks based on their relative significance and probability of occurrence. The IA plan should consider the "universe" of all of the departments' activities (i.e., organizational units and/or business processes).

There are a variety of tools and techniques used to identify and assess risk within an organization. Information and tools utilized to perform an assessment may include mission statement, strategic plan, written policies, written procedures, process experts, sample questions, flowcharts, process narratives, management

internal control evaluations, and audit results. Also, techniques for assessing risks range from the qualitative approach (measures the risk related to business objectives) to the quantitative approach (assigns values to risks based on its impact on an area, initiative, or process). Attached is a flow chart depicting the use of risk assessments in developing internal audit plans and potential risk factors to consider when doing a risk assessment (Attachment A). Also attached is one example of a risk assessment tool to consider in developing your audit plans (Attachment B).

For the upcoming fiscal year, internal audit plans should be submitted to Steve Stier, by October 31, 2003. Internal Auditors should notify OFM of significant revisions to anticipated coverage if internal audit priorities change. Attachment C is a template to be used in reporting audit plan information to OFM.

Please direct any questions related to your internal audit plan to Steve Stier at (517) 373-4010.

Attachment(s)

cc: N. Duncan
S. Stier
R. Lowe

The diagram illustrates the Internal Control Framework, showing the flow from Business Objectives through Strategic Planning and Audit Universe Processes to Annual Plans, which then lead to various assessments and finally to Internal Control Evaluations.

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graph TD
    BO[Business Objectives] --> SP[Strategic Planning Process]
    DSS[Department-Specific Scenarios Approaches Models] --> RABR[Recognition and Appreciation of Business Risk]
    MPMR[Management's Performance Measures and Reward Systems] --> RABR
    OF[Oversight Functions e.g., Commissions, Boards, Executive Team] -.-> ESI[Elements of Significance/Importance to the Strategic Plan]
    OF -.-> IARA[Internal Audit Macro Risk Assessment]
    
    RABR <-->|Common Understanding| SP
    RABR <-->|Common Understanding| AUP[Audit Universe Process]
    SP -- Communication --> AUP
    
    SP --> ABP[Annual Business Plan]
    AUP --> AAP[Annual Audit Plan Review Quarterly]
    ABP -- Communication --> AAP
    
    ABP -. LINK .-> PWO[Process or Work Unit Objectives]
    AAP -. LINK .-> ASB[Assess Business Risks to the Objectives]
    AAP --> IAS[Audits that are part of the Annual Plan]
    IAS --> IAMR[Evaluate How Business Risks are Managed]
    IAMR -- Feedback --> IARA
    
    PWO --> ASB
    ASB --> IAMR
    
    PWO -- Feedback --> ICE[Internal Control Evaluations e.g., Biennial Evaluation, OAG Audits, etc.]
    IAMR -- Feedback --> ICE
    ICE --> CS[Control Share/Transfer Avoid Diversify Accept]

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Key Components and Flow:

- Top Level Inputs:** Business Objectives, Department-Specific Scenarios Approaches Models, Management's Performance Measures and Reward Systems, and Oversight Functions (e.g., Commissions, Boards, Executive Team).
- Central Hub:** Recognition and Appreciation of Business Risk, which interacts with Strategic Planning and Audit Universe processes via Common Understanding.
- Planning Phase:** Strategic Planning Process leads to the Annual Business Plan. The Audit Universe Process leads to the Annual Audit Plan (Review Quarterly). There is communication between the Annual Business Plan and the Annual Audit Plan.
- Execution and Assessment Phase:**
 - The Annual Business Plan links to Process or Work Unit Objectives.
 - The Annual Audit Plan links to Assess Business Risks to the Objectives and the Individual Audit Scope.
 - The Individual Audit Scope leads to Evaluate How Business Risks are Managed.
 - Feedback loops exist from Evaluate How Business Risks are Managed back to both the Annual Audit Plan and the Internal Audit Macro Risk Assessment.
- Final Outcomes:** Internal Control Evaluations (e.g., Biennial Evaluation, OAG Audits, etc.) and Control actions (Share/Transfer, Avoid, Diversify, Accept).

Risk Factors To Consider When Doing A Risk Assessment

1. Size of assets and/or assets under management
2. Annual sales and /or revenues generated
3. Annual withdrawals anticipated
4. Volume of transactions processed
5. Size of operating budget or expenses
6. Accessibility or ability to commit departmental funds
7. Importance to strategic goals and objectives
8. Severity of regulatory penalties
9. Complexity of regulatory requirements
10. Clarity of regulatory requirements
11. Level and span of customer interface
12. Level and nature of IT support required
13. Availability of infrastructure required
14. Experience level of key personnel and management
15. Nature and complexity of training required
16. Vulnerability to errors and fraud
17. Impact on external or internal financial reporting
18. Significant change in operations
19. Related Audit Findings

SAMPLE RISK ASSESSMENT TOOL

RISK RANKING SUMMARY SHEET (AUDIT UNIVERSE)

ITEM NUMBER	AUDIT ENTITY	THEME AREA	RISK RANK	AUDIT CYCLE
5100-00	Operations	IS	180	1
8100-00	Strategic Development	AS	174	1
8200-00	Tactical Purchasing	AS	168	1
5100-00	Capital Renewal	IS	165	1
1100-00	VTS Operations	AGS	161	1
8300-00	Logistics Division	AS	161	1
1400-00	Travel Services	AGS	160	2
1300-00	Records Management	AGS	103	2
3300-00	OFM Business Processes	SBO	92	2
7200-00	State Building Authority	TLS	90	2
3100-00	Budget Office Processes	SBO	90	2
7100-00	Real Estate	TLS	87	2
5000-00	Design and Construction	IS	83	2
1200-00	Operations Division	AGS	81	2
3400-00	MAIN Business Processes	SBO	80	3
9200-00	FS - Operations	FS	79	3
9100-00	Fiscal Management	FS	71	3
4100-00	RS - Operations	RS	70	3
8000-00	State Administrative Board	AS	70	3
2100-00	Organizational Development Division	OS	66	3
2000-00	Human Resources	OS	65	3
3200-00	CEPI Business Process	SBO	62	3
4200-00	Customer Service	RS	60	3
	THEME AREAS			
AGS	- AGENCY SERVICES			
OS	- ORGANIZATIONAL SERVICES			
SBO	- STATE BUDGET OFFICE			
RS	- RETIREMENT SERVICES			
IS	- INFRASTRUCTURE SERVICES			
TLS	- TENANT & LAND SERVICES			
AS	- ACQUISITION SERVICES			
FS	- FINANCIAL SERVICES			

PROGRAM AREA RISK RANKING

Audit Entity: VTS Operations		Prepared By: JIA		Date: 9/8/2003	
Owner: Mr. Star		Area: AGS		Item #: 1100-00	
Risk Factor					Factor Weight
Factor 1	Assets				30
Factor 2	Control Awareness				20
Factor 3	Size				27
Factor 4	Management/Staff Interest				17
Factor 5	Significant Changes				19
Factor 6	Environmental Factors				10
Factor 7	Legal/Regulatory Environment				10
Factor 8	Independent Reviews				28
Total					161
Explanation of Ranking Score		Risk Ranking		Audit Cycle	
0	No concern	161		1	
1 - 10	Little concern				
11 - 20	Average concern				
21 - 30	Definite concern				
COMMENTS					
<p>Factor 1: Assets include the State's vehicle fleet,</p> <p>Factor 2: All managers were exposed to JWI Internal control training in 2000</p> <p>Factor 3: \$ 2 million in net assets, operating loss in ty02</p> <p>Factor 4: Department Reorganization in ty 2002</p> <p>Factor 5: No major changes</p> <p>Factor 6:</p> <p>Factor 7: No legal or regulatory concerns</p> <p>Factor 8: OAG reports have identified 1 reportable finding and 3 other findings in VTS Operations.</p>					
NOTE : Audit Cycle is determined based on risk ranking for a three year audit cycle.					

Risk Assessment Rating Sheet

Name: Joe I. Auditor

Title: Internal Auditor

Area of Responsibility: Agency Services – VTS Operations

Date: 09/08/2003

Ratings Key	
21 - 30	This factor is of very definite concern or applicability
11 - 20	This factor is of average concern or applicability
1 - 10	This factor is of little concern or very slightly applicable
0	This factor is of no concern

Assets at Risk

Factor Weight 30

Items to Consider:

1. The type of assets under your control
2. Total net assets controlled or accounted for by your area. Please specify your actual or estimated net assets in the comment section below.
3. How easy it would be to convert these assets into cash
4. Is the information in your area considered proprietary, confidential and/or financial? Circle all that apply.
5. Shareholder concerns
6. Your perceptions of the impact of errors, omissions, losses or fraud in your area on such issues as:
 - Publicity
 - Political Sensitivity
 - Retail Customers
 - Users of Your Systems
 - Company Operations

Comments:

Control Awareness

Factor Weight 20

Items to consider:

1. Your staff's knowledge of controls
2. Management's knowledge of controls
3. History of problems caused by either a lack of controls or a breakdown of existing controls
4. Your perception of the opportunity for fraud to occur in this area
5. Existence of any "self audit" processes completed and their effectiveness
6. Existence of any agencies that monitor/review your area's activities
7. System development methodology used
8. Is the information generated/maintained confidential?
9. Is the information generated/maintained accurate?
10. Is the information generated/maintained backed up in case of system failure?

Comments:

Size of Process, Function or Operation

Factor Weight 27

Items to consider:

1. Number of transactions processed annually
2. Total dollar value of the transactions processed annually
3. Size of staff
4. Size of the departmental budget
 - Revenue
 - Capital Expenditures
 - Operating and General Expenses
5. Growth rate experienced during the last two years
6. The extent that corporate financial results or operating decisions rely on your department's performance

Comments:

Management/Staff Interest or Concern

Factor Weight 17

Items to Consider:

1. Experience of your staff
2. Recent changes in department management
3. High management interest in your area
4. Audit requested by management as a result of concern

Comments:

Significant Changes in Business, Operations, Processes or Technology

Factor Weight ____19____

Items to consider:

1. New technology installed/implemented in your area in the last year
2. New organizational structure implemented in the last year
3. Any functions outsourced in the last year
4. The extent to which your area's operations, processes, or technology are centralized or decentralized
5. Recent competitive developments affecting your operations

Comments:

Environmental Factors

Factor Weight ____10____

Items to consider:

1. High crime area
2. Your area operates in an area susceptible to natural disasters (earthquake, flood, etc.)
3. Prior history of fraud
4. Physical location within your building
5. Any international operations
6. Government stability
7. Complexity of operations
8. Computer systems:
 - Stability
 - Criticality
 - Age
 - Uniqueness
 - Remote Access
 - System Interfaces
 - In-house developed product vs. vendor purchased

Comments:

Legal/Regulatory Environment

Factor Weight ____10____

Items to consider:

1. Existing legislation pertaining to your operations
2. Future legislation being contemplated
3. Penalties for non compliance
4. Subject to outside review by regulatory agency

Comments:

Independent Review History

Factor Weight ____28____

Items to consider:

1. Never reviewed by OAG or Internal Audit
2. Not reviewed by OAG or Internal Audit in last five years
3. Poor results on prior review
4. Weakness identified in management's biennial evaluation of internal controls

Comments:

Department of XXXXXXXXX
Internal Audit Plan for the period XXX 99, 2003 thru XXX 99, 2004

Audit Project	Audit Resources Required (hours and/or dollars)	Classification of Audit (e.g. financial, performance)	Information Technology Related (Y/N)	Comments